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IN THE

SUPREME COURT OF THE UNITED STATES.

No. 217

GENERAL BANCSHARES CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

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To the United States Court of Appeals for the Eighth Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, General Bancshares Corporation, a Missouri corporation, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit in the cause styled "General Bancshares Corporation, Petitioner, v. Commissioner of Internal Revenue, Respondent," affirming the judgment of the Tax Court of the United States.

The opinion of the Court of Appeals is reported at 326 F. 2d 712, and a copy thereof is appended. The opinion of the Tax Court is reported at 39 T. C. 423.

JURISDICTION.

The judgment of the Court of Appeals is dated January 28, 1964, and was entered on the same date. The time for filing this petition was extended to and including June 26, 1964. Jurisdiction of this Court to review

the judgment of the Court of Appeals is conferred by the Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U. S. C. § 1254.

QUESTION PRESENTED.

The question presented for review is whether expenditures incurred by petitioner in connection with the payment of regularly recurring semi-annual 2 per cent stock dividends are deductible in computing its taxable income for federal income tax purposes as ordinary and necessary expenses of carrying on its trade or business. The Tax Court and the Court of Appeals held that such expenses are not deductible on the ground that they are capital expenditures.

STATUTES INVOLVED.

The statutes involved are Sections 162 (a) and 263 (a) of the Internal Revenue Code of 1954, 26 U. S. C. § 162 (a), 263 (a).

The pertinent text of the above statutes is appended.

STATEMENT OF THE CASE.

Petitioner is a Missouri corporation with offices in St. Louis, Missouri. It was incorporated in 1946 as General Contract Corporation and subsequently amended its charter, changing its corporate name to General Baneshares Corporation. Petitioner's capital structure consists of common stock, par value two dollars per share, and several classes of preferred stock. It is essentially a holding company, owning controlling interests in subsidiary corporations engaged in the banking and insurance businesses. Petitioner's income is comprised principally of dividends received from its subsidiaries.

Beginning in October, 1955, petitioner paid regular, semi-annual 2% stock dividends in its common stock to holders of its common stock. Such stock dividends were

paid in October, 1953; April, 1956; October, 1956; April, 1957; and October, 1957. At December 31, 1956, prior to the first 1957 stock dividend, petitioner had 2,162,547.9 shares of its $2 par value common stock issued and outstanding, having a total par value of $4,325,095.80. At that date petitioner also had a capital surplus of $11,759,986, and an earned surplus of $1,679,351. In paying the stock dividends, petitioner charged the aggregate fair market value of the dividend shares to earned surplus, credited $2 per share to capital stock account and the excess of the fair market value of the dividend shares over $2 per share to capital surplus. Giving effect to the two stock dividends paid in 1957, at December 31, 1957, petitioner had 2,249,935.4 shares of its $2 par value common stock issued and outstanding, having a total par value of $4,499,870.80, an increase of $174,775 over the figure at the end of the previous year. Earned surplus was reduced by $1,156,582.50, consisting of the $174,775 added to capital stock account plus $981,807.50 added to capital surplus.

During the year 1957, petitioner paid stock transfer agent's fees and several other items arising out of the 2% stock dividends paid in April and October of that year.

At all material times, petitioner maintained its books and filed its income tax returns on the accrual method of accounting and on the basis of the calendar year. It filed its corporation income tax return for the year 1957 with the District Director of Internal Revenue at St. Louis, Missouri. On its said return, petitioner claimed a deduction in the aggregate amount of $22,176.50 for its payment of the aforesaid items of expense related to the 1957 stock dividends. During the year 1958, petitioner paid additional items in the total amount of $18,413.82 as additional expenses arising out of the payment of said stock dividends in 1957. Respondent in his-

audit of petitioner's 1957 return disallowed the deduction of said amount of $22,176.50 for expenses paid in 1957, but allowed $2,801.02 of the total of $18,413.82 paid in 1958, on the theory that to this extent the items paid in 1958 were ordinary and necessary business expenses which accrued in 1957. Petitioner in the Tax Court proceedings, besides contesting the deficiency based upon disallowance of the $22,176.50 amount, claimed an overpayment on its 1957 return based upon respondent's failure to allow the balance of $15,612.80 of expenses accrued in 1957 and paid in 1958. It was stipulated in the Tax Court that, whether or not any of such items paid in 1958 was deductible, the entire amount of $18,413.82 paid in 1958 was properly accruable in 1957.

In the Tax Court proceedings, the respondent contended that the several items comprising said amounts of $22,176.50 paid in 1957 and $15,612.80 paid in 1958 are capital expenditures and as such not deductible. Petitioner contended that said items are ordinary and necessary business expenses, deductible as such.

The Tax Court held that the items of expense involved in paying the stock dividends and which were disallowed as deductions by respondent were "capital in nature" and not deductible.

Petitioner petitioned the Court of Appeals to review the decision of the Tax Court. The Court of Appeals affirmed the decision of the Tax Court.

REASONS FOR ALLOWANCE OF THE WRIT.

The reasons relied on for allowance of the writ of certiorari are that the Court of Appeals in this case (1) has decided an important question of federal law which has not been, but should be, settled by this Court; and (2) has decided that question in a way in conflict with decisions of this Court applicable to the general problem involved.

ARGUMENT.

1. This Court, in the recent (February 18, 1963) cases of **United States v. Gilmore**, 372 U. S. 39, 9 L. ed. 2d 570, and **United States v. Patrick**, 372 U. S. 53, 9 L. ed. 2d 580, settled a question of great importance to individual taxpayers: where to draw the line between ordinary and necessary expenses incurred for the conservation of income-producing property (the "non-business" expenses deductible under Section 212 of the Internal Revenue Code), on the one hand, and personal, living, or family expenses (non-deductible under Section 262 of the Code), on the other hand, as applied to the case where a husband incurs legal expenses in divorce proceedings and seeks to deduct such portion of the lawyer's fees as can be traced to the financial or property settlement aspects of the marital controversy. This Court granted certiorari in those cases partly because of "the continuing importance of the question in the administration of the federal income tax laws." **U. S. v. Gilmore**, 9 L. ed. 572.

In the instant case we are concerned with a parallel problem affecting corporate taxpayers, i. e., where to draw the line between "ordinary and necessary expenses incurred in carrying on any trade or business" (deductible under Section 162 of the Code), on the one hand, and "capital expenditures" (a term used in the title of Section 263 in denying deductibility for certain items therein described), on the other hand, as applied to the case where a corporation incurs expenses in issuing stock in payment of regular, recurrent stock dividends.

As noted by the Tax Court in its opinion, the question presented is one of first impression (39 T. C. 425), and as noted by the Court of Appeals in its opinion, it "seems a little surprising that an issue of this kind arises so late and only after the nation has lived with the federal income tax for more than half a century." C. A. Opinion, p. 3

(326 F. 2d 713). The most reasonable explanation for this phenomenon is that the Commissioner himself until 1960 regarded stock dividend issue cost as deductible business expense. In 1960 he announced a contrary view, holding such cost to be a "capital expenditure." Rev. Rul. 60-254, 1960-2 C. B. 42.

The importance of this question transcends the area of immediate concern, the issuance of corporate stock, because of the rationale of the decision below and the implications of that rationale. Both the Tax Court and the Court of Appeals held that, without necessity for inquiry into the "ordinary and necessary" character of a particular item of expense incurred by a business corporation, the item is not deductible if it falls within the shadowy reaches of a vague "capital expenditure" concept. Thus, the Tax Court concluded: "Certain expenditures which are **capital in nature** but do not cause any increase in the value of an asset are not deductible as ordinary and necessary business expenses" (39 T. C. 427) (Emphasis supplied). The Court of Appeals was even more ephemeral:

> "So in approaching our problem here we must accept 'life in all its fullness' as our standard. When we do so, we conclude that at this late date we are not free to depart from what we regard as established and controlling precedent differentiating between ordinary and necessary business expense, on the one hand, **and something else, usually referred to as an expenditure to be capitalized**, on the other . . ." C. A. Opinion, p. 5 (326 F. 2d 714) (Emphasis supplied).

Thus, the broad question of statutory construction raised here is whether Section 162 (a), in its allowance of deductions for "all the ordinary and necessary expenses paid or incurred . . . in carrying on any trade

or business . . . ." is limited by an exception for which no express authority can be found elsewhere in the Code, or whether, as this taxpayer maintains, the only exception to Section 162 (a) of the kind relied on by the courts below—"capital expenditures"—is that expressed in Section 263, disallowing certain items there called by that name in the caption; thus creating a statutory pattern parallel to that of Section 212 and Section 262, as elucidated by this Court in **Gilmore** and **Patrick**, *supra*.

A brief glance at the applicable statutes reveals the significance of the question presented and suggests the gravity of the error which taxpayer contends was committed by the courts below. Emphasis, where shown, has been supplied. We begin with Section 161, which provides for allowance of deductions generally:

> "In computing taxable income . . . there shall be allowed as deductions the items specified in this part, subject to the **exceptions** provided in part IX (Sec. 261 and following, relating to items not deductible)." I. R. C. 1954, Sec. 161.

Section 162 (a) then provides:

> "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred . . . in carrying on any trade or business, including . . . ." I. R. C. 1954, Sec. 162 (a).

The Commissioner's Regulations under Section 162 (a) add:

> "(a) In general. Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business . . . Among the items included in business expenses are management expenses, **commissions (but see section 263 and the Regulations thereunder)**. . . ."

"(b) Cross references . . . (2) For items not deductible, see sections 261-273, inclusive, and regulations thereunder." Reg., Sec. 1.162-1.

As stated in Section 161, *supra*, the "exceptions" to the general rules of deductibility provided by Section 162 et seq. are contained in Section 261 et seq. That section provides:

"In computing taxable income no deduction shall in any case be allowed in respect of the items **specified** in this part." I. R. C. 1954, Sec. 261.

(Section 262, captioned "Personal, Living and Family expenses," was applied by this Court in the **Gilmore** and **Patrick** cases, *supra*, as a categorical exception to the rule of Section 212 allowing deductions for expenses of conserving income-producing property. It was held that certain legal expenses, because of the origin of the matter to which they related, were of a personal rather than an economic character.)

Section 263 is entitled "Capital Expenditures." It provides in part:

"No deduction shall be allowed for—

(1) Any amount paid out for **new buildings or for permanent improvements or betterments** made to increase the value of any property or estate. . . .

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made." I. R. C. 1954, Sec. 263 (a)

Again, the meaning is amplified in the Commissioner's Regulations, which in Section 1.263 (a)-1 (a) substantially repeat the provisions quoted above from the statute, then add:

"(b) In general, the amounts referred to in paragraph (a) of this section include amounts paid or incurred (1) **to add to the value**, or substantially prolong the useful life, of property owned by the taxpayer, such as plant or equipment, or (2) to adapt property to a new or different use."

It is submitted that, on any proper analysis of these statutes and regulations, it must be concluded that the intended relationship of Section 162 (a) and Section 263 is such that:

(1) If a particular item of expense meets the test of "business" nature and "ordinary and necessary" character, it is allowable as a deduction under Section 162 (a) **unless** it falls within the exceptional category of "capital expenditure" described by Section 263.

(2) Section 263 in describing capital expenditures limits them to such items of expense as **add substantial value** to tangible property, usually of a depreciable character.

The Tax Court and the Court of Appeals in the instant case rejected the foregoing analysis; and while not even exploring (let alone denying) the business nature and ordinary and necessary character of stock dividend issue expenses, held them to be non-deductible on the basis of their effect in altering the "capital structure," i. e., the capital stock account on the books of the corporate taxpayer. They reached this conclusion on the basis of precedents, involving issuance of stock **under other circumstances** than payment of stock dividends all of which can be readily explained in terms of either (1) the fact that the issuance of stock was not an **ordinary and necessary** incident of the conduct of the business, e. g., where stock is issued upon initial organization or upon reorganization of the corporation, or (2) the fact that the stock was **issued for cash**, thus adding to the value

of the corporate property and falling, possibly, within the category of capital expenditure as described in Section 263. See C. A. opinion, pp. 6-8, 326 F. 2d 715-716.

2. Moreover, the Court of Appeals decided the question in this case in a manner conflicting with decisions of this Court dealing with other business expense deduction questions. **Trust of Bingham et al. v. Commissioner** (1945), 325 U. S. 365; **Commissioner v. Heininger** (1943), 320 U. S. 467; **Lilly et al. v. Commissioner** (1952), 343 U. S. 90; **Deputy et al. v. duPont** (1940), 308 U. S. 488.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Eighth Circuit, to review its decision in the case numbered and entitled on its docket, No. 17,313, General Baneshares Corporation, Petitioner v. Commissioner of Internal Revenue, Respondent; and that the judgment of said Court in said case be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

Respectfully submitted,

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APPENDIX.

1. OPINION OF THE COURT OF APPEALS.

United States Court of Appeals
For the Eighth Circuit.

No. 17,313

General Baneshares Corporation, Petitioner, v. Commissioner of Internal Revenue, Respondent.	Petition for Review of Decision of the Tax Court of the United States.

[January 28, 1964.]

Before Van Oosterhout and Blackmun, Circuit Judges, and Hanson, District Judge.

Blackmun, Circuit Judge.

The Tax Court has held that certain 1957 costs incurred by General Baneshares Corporation in issuing non-taxable stock dividends are not deductible as ordinary and necessary business expenses under § 162 (a) of the Internal Revenue Code of 1954, 26 U. S. C. A., § 162 (a). Judge Scott's opinion, not reviewed by the full court, is reported at 39 T. C. 423. The taxpayer has petitioned for review.

The facts are stipulated. Baneshares, formerly known as General Contract Corporation, was incorporated in Missouri in 1946. It had outstanding common shares and

three classes of par value preferred. Its primary assets were stocks in controlled corporations in the banking and insurance fields; the major part of its income consisted of dividends from these stocks. The taxpayer maintained its books and filed its income tax returns on the accrual method of accounting and on the basis of the calendar year.

Baneshares paid 2% stock dividends on its common in 1950, in October 1955, in April 1956, and in October 1956, and one of 6% in 1951. In its returns as filed it deducted any expenses incurred in issuing these stock dividends. We assume, although the record does not so disclose, that these deductions were not challenged by the Commissioner.

In 1957 the taxpayer again issued stock dividends on its common. The first was in April and the second was in October. Each was 2%. The taxpayer incurred expenses, all properly accruable in that year, in the issuance of these stock dividends.[1] Baneshares' 1957 return showed an increase during the year of $174,777 in its outstanding common stock capital account and a charge to earned surplus during the year of $174,736 for stock distributed to share-

[1] The parties, by their stipulation describe many of these in the aggregate "as expense of issuing stock dividends" and the others as "expenses incurred in connection with stock dividends paid". Actually they consisted of stationery and printing costs, postage, stock exchange listing costs, and transfer agent and registrar expenses and fees. Certain of the transfer agent and registrar costs were allowed on audit. We feel that all the remaining expenses stand or fall together in the determination of the issue whether stock dividend expense is deductible. We therefore disregard as of no weight here the taxpayer's suggestions that, because some of the expenses were for "personal services actually rendered", they are clearly deductible under § 162 (a) (1), and that the Tax Court's disallowance amounts to an improper recognition of cost accounting. In any event, as the cases cited later in the opinion show, organizational expenses and others of comparable nature, although they include payments for personal services as, for example, attorney's fees, are not deductible under § 162 (a). *Frischkorn Real Estate Co.*, 21 B. T. A. 963, 969 (1930), dismissed on taxpayer's motion, 51 F. 2d 1077 (6 Cir.).

holders. The slight difference between these figures is not explained.

The problem before us, therefore, is whether these 1957 stock dividend costs qualify as "ordinary and necessary expenses" of the business deductible under § 162 (a). The Tax Court concluded that the stock dividends "have caused a change in petitioner's capital structure, even though no new capital was acquired" and that the expenditures were "capital in nature and not deductible."

It seems a little surprising that an issue of this kind arises so late and only after the nation has lived with the federal income tax for more than half a century. The Tax Court, however, notes that the case is one of first impression. Indeed, it so appears to be, although now there are at least two later Tax Court cases, both decided by Judge Withey, which follow this one and are now on appeal elsewhere. **United Industrial Corp. & Subsidiary Companies**, 21 T. C. M. 1482, T. C. Memo. 1962-280, on petition for review to the Sixth Circuit; **Arkansas Louisiana Gas Co.**, 22 T. C. M. 331, T. C. Memo. 1963-77, on petition for review to the Fifth Circuit. This fairly development of the issue may, of course, be due to taxpayers failing to claim such expenses as deductions; or, if asserted, to their escaping notice on audit; or to a change in attitude, undisclosed here, on the part of the Internal Revenue Service. In any event, the Service's position since 1950 is clear for Rev. Rul. 60-254, 1960-2 C. B. 42, promulgated about the time the issues in the present case were being drawn, flatly states:

> "Cost incurred by a corporation in connection with the issuance of its capital stock in payment of a stock dividend is not deductible as an ordinary and necessary business expense under section 162 of the Internal Revenue Code of 1954, since such cost is a capital expenditure."

The taxpayer argues that the Tax Court's relating the stock dividend expenses to organization expense, with consequent non-deductibility, is a mis-analysis; that on the decided cases, that result is limited to expenditures incidental to an actual increase in capital assets; that non-deductibility does not ensue where there is no more than a change in capital stock account which, of course, does not accurately reflect underlying value anyway; that the stock dividends here added nothing to the taxpayer's capital assets but only affected the earned surplus and capital stock accounts on the liability side of the ledger; that the costs were incurred in "carrying on" the taxpayer's business, within § 162 (a); that making a better case is part of carrying it on; that the stock dividends were regular and not occasional, conserved cash, and served as a substitute for short term borrowing; and that the result reached by the Tax Court embraced cost accounting and was not to be given the income tax effect the court applied.

We agree with the Service and with the Tax Court. There is, of course, much to be said for the taxpayer's position. To the mind of a practical corporate officer or, as has sometimes been said, of the "hard headed businessman," see 4 Mertens, Law of Federal Income Taxation, § 25.09, p. 31; **Rittenberg v. United States**, 267 F. 2d 605, 608 (5 Cir. 1959), cert. denied 361 U. S. 931, the costs of the issuance of a stock dividend may seem just as current and, where stock dividends have assumed some aspect of regularity, as is unarguably the case with this taxpayer and with many public utilities, just as ordinary and necessary as the expenses of a cash dividend or of a dividend which the shareholder may elect to receive in cash or in stock.

Whenever § 162 (a) is at issue, however, we are reminded of **Welch v. Helvering**, 290 U. S. 111 (1933), and

Mr. Justice Cardozo's observations there, pp. 114-15, that the "decisive distinctions are those of degree and not of kind"; that one "struggles in vain for any verbal formula that will supply a ready touchstone"; and that, in words of apparent wistful disappointment because of the lack of greater certainty, "The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle". So in approaching our problem here we must accept "life in all its fullness" as our standard. When we do so, we conclude that at this late date we are not free to depart from what we regard as established and controlling precedent differentiating between ordinary and necessary business expense, on the one hand, and something else, usually referred to as an expenditure to be capitalized, on the other, and that the expenses of a non-elective stock dividend are essentially capital in nature and are not deductible. We consider the following facts and precedents, some of the latter established only after extended litigation, to be indicators which compel the conclusion we reach:

1. It cannot be denied that the issuance of the stock dividends in 1957, irrespective of their tax consequence to the receiving shareholders, did effect a change in the capital structure of the taxpayer corporation. They embraced, in addition to the increase in the number of shares outstanding, conversions of part of the existing earned surplus into capital. The amounts so converted are unavailable so far as corporation law is concerned, for the payment of ordinary dividends in the future. **Eisner v. Macomber**, 252 U. S. 189, 210-11 (1920); **United States v. Zions Sav. & Loan Ass'n**, 313 F. 2d 331, 335 (10 Cir. 1963); **Buckeye Sav. & Loan Co. v. United States**, 312 F. 2d 912, 918 (Ct. Cls. 1963); **United States v. Siegel**, 52 F. 2d 63, 65 (8 Cir. 1931), cert. denied, 284 U. S. 679; 11 Fletcher, Cyclopedia Corporations (1958 Rev.), § 5362. Specifically is this so under Missouri law. V. A. M. S.,

§ 351.220, subdivision (3); **Hayes v. St. Louis Union Trust Co.**, 347 Mo. 1028, 298 S. W. 91, 98 (1927); **Robert v. Mercantile Trust Co.**, 324 Mo. 314, 23 S. W. 2d 32, 41 (1929). The stock dividends thus increased the taxpayer's capital and decreased its earned surplus. We must assume that these moves were made for positive reasons directed toward the company's betterment. Initially, and offhand, therefore, the expenditures in connection with the stock dividends seem to smack of a capital or permanent or betterment nature related more to the type of item exemplified by the prohibitions of § 263 (a) of the 1954 Code,[2] than to expenses having to do with the daily carrying on of a business and the production of current income to which § 162 (a) has application.

2. Other costs which have to do basically with corporation structure have been denied status as ordinary and necessary business expenses under § 162 (a) and its predecessors. Significant examples are:

(a) Organization expenditures (except as now specifically amortizable over a limited period by § 248). **Grain King Mfg. Co.**, 14 B. T. A. 793, 796 (1928), petition for review dismissed on jurisdictional grounds, 47 F. 2d 608 (2 Cir.); **Estate of George B. Leonard Holding Corp.**, 26 B. T. A. 46, 47 (1932); **Motion Picture Capital Corp. v. Commissioner**, 80 F. 2d 872, 873 (2 Cir. 1936).

(b) Expenditures of reorganizing or recapitalizing. **Gravois Planing Mill Co. v. Commissioner**, 299 F. 2d 199, 206 (8 Cir. 1962); **International Bldg. Co. v. Commissioner**, 199 F. 2d 12, 26 (8 Cir. 1952), reversed on other grounds, 345 U. S. 502; **Missouri-Kansas Pipe**

[2] § 263. Capital expenditures.

(a) General rule.—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate * * *.

Line Co. v. Commissioner, 148 F. 2d 460, 462 (3 Cir. 1945); **Skenandoa Rayon Corp. v. Commissioner,** 122 F. 2d 268, 271 (2 Cir. 1941), cert. denied 314 U. S. 696.

(c) Expenditures in connection with the issuance or increase of non-dividend corporate stock. **Motion Picture Capital Corp. v. Commissioner,** supra, p. 873 of 80 F. 2d; **Simmons Co. v. Commissioner,** 33 F. 2d 75 (1 Cir. 1929), cert. denied 280 U. S. 588; **Fishing Tackle Products Co.,** 27 T. C. 638, 645 (1957); **Firemen's Ins. Co.,** 30 B. T. A. 1004, 1014 (1934); **Baltimore & Ohio R. R.,** 29 B. T. A. 368, 372 (1933), aff'd 78 F. 2d 460 (4 Cir.); **Borg & Beck Co.,** 24 B. T. A. 995, 1004 (1931); **Emerson Electric Mfg. Co.,** 3 B. T. A. 932, 935 (1926).

The rationale behind these decisions appears to us to be that the purpose for which the expenditure is made has to do with the corporation's operations and betterment, sometimes with a continuing capital asset, for the duration of its existence or for the indefinite future or for a time somewhat longer than the current taxable year, in contrast to being devoted to the income production or other needs of the more immediate present. See **Motion Picture Capital Corp. v. Commissioner,** supra, p. 873 of 80 F. 2d; **First Nat'l Bank of St. Louis,** 3 B. T. A. 807 (1926); 4 Mertens, Law of Federal Income Taxation, § 25.35. The Ninth Circuit recently emphasized this when it said, "Expenses incurred for the purpose of changing the corporate structure for the benefit of future operations are not ordinary and necessary business expenses. . . ." **Farmers Union Corp. v. Commissioner,** 300 F. 2d 197, 200 (9 Cir. 1962), cert. denied 371 U. S. 861.

3. Although the taxpayer argues to the contrary, it has been held that, where the expenditures have not resulted in the acquisition or increase of a corporate asset, the

result is still the same and these expenditures are not, because of that fact, deductible as ordinary and necessary business expenses. **Baltimore & Ohio R. R.**, supra, p. 373 of 29 B. T. A.; **Holeproof Hosiery Co.**, 11 B. T. A. 547, 556 (1928). We observe in this connection, however, that the Second Circuit, in denying deductibility of reorganization expenses has said: "They are instead a part of the expenditure needed to give the corporation an intangible asset which we may call its altered corporate structure • • •" **Mills Estate, Inc. v. Commissioner**, 206 F. 2d 244, 246 (2 Cir. 1953).

4. Section 263, with its denial of deductibility for specified capital expenditures, and § 162 (a), with its grant of deductibility for ordinary and necessary business expenses, are not, of course, mutually exclusive. Neither are they together all inclusive. Section 263 obviously is not in itself an exclusive list of non-deductible capital expenditures. Further, § 162 requires for deductibility not only that an item be a business expense but that it be "ordinary and necessary". **Baltimore & Ohio R. R.**, supra, pp. 372-73 of 29 B. T. A.; **Holeproof Hosiery Co.**, supra, p. 556 of 11 B. T. A.; **Dome Mines, Ltd.**, 20 B. T. A. 377, 378 (1930); 4 Mertens, Law of Federal Income Taxation, § 25.20, pp. 76-77.

5. Section 248 was new in the 1954 Code. It permits, under stated conditions the amortized deduction of a corporation's organizational expenditures. At the Committee hearings on the 1954 Code suggestions were made that this new section be drawn to apply to stock dividend expenditures. H. R. No. 1337, 83d Cong., 2d Session, p. A64, 3 U. S. Code Congressional and Administrative News (1954) 4017, 4291, flatly states, however, that "Expenses of issuing shares of stock • • • are a reduction of the proceeds derived from the issue, and are properly chargeable against the paid-in capital. Such expenses are not

organizational expenses within the meaning of section 248 * * *." Although this refers to the situation where there are proceeds derived from a stock issue, it clearly discloses, it seems to us, the attitude of Congress as to the nature of stock issuance expenditures and congressional opposition to their deductibility even under the relief provisions of the new § 248.

6. The fact that these stock dividends, by § 305(a), were not taxable to the shareholder recipients and, by § 312(d)(1)(B), did not for income tax purposes reduce the amount of available earnings to be considered in determining the taxability of future distributions to shareholders, in contrast to their capitalization for corporate accounting purposes, is of no significance. This precise situation is not unknown. **Sheehan v. Dana**, 163 F. 2d 316, 318 (8 Cir. 1947); **Long v. Commissioner**, 155 F. 2d 847, 849 (6 Cir. 1946); **United States v. Lesoine**, 203 F. 2d 123, 125 (9 Cir. 1953); See **Commissioner v. Estate of Bedford**, 325 U. S. 283, 290 (1945).

Perhaps all this merely brings us back to where we started, namely, that, as the Supreme Court said in **Welch v. Helvering**, supra, in cases in this area we are necessarily dealing in matters of distinction in degree and not in kind, that there is no readily available formula; and that the standard is "a way of life." Having in mind that the taxpayer's task here is to qualify its expenditures not only as non-capital in nature but as ordinary and necessary business expenses under § 162 (a); that it is not enough to demonstrate that they possess some characteristics different from the more commonly accepted capital expenditures (such as those directed toward the acquisition of a recognizable and tangible corporate asset); that the burden of proof is on the taxpayer, **Interstate Transit Lines v. Commissioner**, 319 U. S. 590, 593 (1943); **Mississippi River Fuel Corp. v. Koehler**, 266 F. 2d 190, 196 (8 Cir. 1959),

cert. denied 361 U. S. 827; that the determination whether these expenditures are ordinary or necessary business expenses is a question of fact. **Commissioner v. Heininger**, 320 U. S. 467, 475 (1943); **Long v. Commissioner**, 277 F. 2d 239, 240-41 (8 Cir. 1960); and that the established precedents uniformly appear as indicators of non-deductibility, we hold that the stock dividend expenses in this case are not deductible from gross income. If a different conclusion is to be reached, that end is for the Congress and not for the federal courts. The decision of the Tax Court is therefore,

Affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

2. TEXT OF STATUTES AND REGULATIONS INVOLVED.

Sec. 162 (a), Internal Revenue Code of 1954:

"(a) **In General.**—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of

property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, Territory, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000."

Sec. 263 (a), Internal Revenue Code of 1954:

"(a) **General Rule.**—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174, or

(C) soil and water conservation expenditures deductible under section 175.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made."

Income Tax Regulations, Part 1, Sec. 1.162-1, Business Expenses (Title 26, Code of Federal Regulations):

"(a) **In general.** Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the

taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than section 162. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. See paragraph (a) of § 1.161-3. Among the items included in business expenses are management expenses, commissions (but see section 263 and the regulations thereunder), labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see § 1.162-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business and rental for the use of business property. No such items shall be included in business expenses, however, to the extent that it is used by the taxpayer in computing the cost of property included in its inventory or used in determining the gain or loss basis of its plant, equipment or other property. Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. In the case of any sports program to which section 114 (relating to sports programs conducted for the American National Red Cross) applies, expenses described in section 114 (a) (2) shall be allowable as deductions under section 162 (a) only to the extent that such expenses exceed the amount excluded from gross income under section 114 (a)."

Income Tax Regulations, Part 1, Sec. 1.263 (a)-1. Capital expenditures in general. (Title 26, Code of Federal Regulations:)

"(a) Except as otherwise provided in chapter 1 of the Code, no deduction shall be allowed for

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate, or

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made in the form of a deduction for depreciation, amortization, or depletion.

(b) In general, the amounts referred to in paragraph (a) of this section include amounts paid or incurred (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, such as plant or equipment, or (2) to adapt property to a new or different use. Amounts paid or incurred for incidental repairs and maintenance of property are not capital expenditures within the meaning of subparagraphs (1) and (2) of this paragraph. See Section 162 and 1.162-4."

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 217

GENERAL BANCSHARES CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION.

OPINIONS BELOW

The opinion of the Tax Court (Doc. No. 6) is reported at 39 T.C. 423. The opinion of the court of appeals (Pet. 11–20) is reported at 326 F. 2d 712.

JURISDICTION

The judgment of the court of appeals was filed on January 28, 1964. On April 21, 1964, Mr. Justice White granted an extension of time for the filing of a petition for a writ of certiorari to and including June 26, 1964, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

738-873—64

QUESTION PRESENTED

Whether costs incurred by the taxpayer in issuing its capital stock as a stock dividend are deductible as ordinary and necessary expenses of carrying on a trade or business under Section 162(a) of the Internal Revenue Code of 1954.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1954:

> SEC. 162. TRADE OR BUSINESS EXPENSES.
>
> (a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.
>
> * * * * * * *
>
> SEC. 263. CAPITAL EXPENDITURES.
>
> (a) *General Rule.*—No deduction shall be allowed for—
>
> (1) Any amount paid out for new buildings or permanent improvements or betterments made to increase the value of any property or estate. * * *

Treasury Regulations on Income Tax (1954 Code):

> SEC. 1.162-1. BUSINESS EXPENSES.
>
> (a) *In general.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *. Among the items included in business expenses are management expenses, commissions (but see section 263 and the regulations thereunder), labor, supplies, incidental repairs * * *.

STATEMENT

The taxpayer, a Missouri corporation, held stocks in controlled corporations in the banking and insurance fields, and the major part of its income consisted of dividends from these companies (Pet. 11–12). The taxpayer paid 2 percent stock dividends on its common stock in 1950, in October 1955, in April 1956, and in October 1956, and one of 6 percent in 1951. In 1957, the taxpayer issued two 2 percent stock dividends on its common stock, first in April and then again in October. Its 1957 income tax return disclosed an increase during the year in its common stock capital account of $174,775 and a charge to earned surplus of $174,736 for stock distributed to stockholders during that year (Pet. 12–13). It incurred expenses of $40,599.32 in connection with the issuance of the 1957 stock dividends, which, except for $2,801.02, the Commissioner refused to allow as a business expense deduction for that year (Doc. No. 6, pp. 2–3).

In sustaining the Commissioner's action, the Tax Court noted that the amount of the stock dividends became a permanent part of the taxpayer's stated capital, no longer available under local law for distribution as ordinary dividends. Thus, the stock dividends effected a permanent change in the taxpayer's capital structure. Relying on cases holding that expenses incurred by a corporation for its organization or for subsequent changes in the amount of its capital stock are considered to be non-deductible capital expenditures, even where no new capital or any tangible assets were acquired, the court held the stock dividend expenditures were not deductible as ordinary and

necessary business expenses. The court of appeals affirmed (Pet. 11–20).

ARGUMENT

Since the decision below is correct and there is no conflict in decisions, there is no reason for further review.

1. Section 263 of the Internal Revenue Code of 1964 provides that capital expenditures—including "[a]ny amount paid out for * * * permanent improvements or betterments made to increase the value of any property or estate"—may not be deducted. On the other hand, Section 162 allows a deduction for "all the ordinary and necessary expenses paid or incurred * * * in carrying on any trade or business." The regulations provide that the expenses must be "directly connected with or pertaining to the taxpayer's trade or business." Treasury Regulations on Income Tax (1954 Code), Sec. 1.162–1.

It is well established that expenditures incurred in organizing, reorganizing, and recapitalizing a corporation (including expenditures of stock issues which are part of any of these activities) are not deductible as ordinary and necessary business expenses. *E.g., Gravois Planing Mill Co.* v. *Commissioner*, 299 F. 2d 199, 206 (C.A. 8); *Shenandoah Rayon Corp.* v. *Commissioner*, 122 F. 2d 268, 271 (C.A. 2), affirming 42 B.T.A. 1287, certiorari denied, 314 U.S. 696. The same is true of outlays made to increase or issue a

Certain expenses in originally forming a corporation are now specifically amortizable, however, under Section 248 of the 1954 Code.

corporation's capital stock. *E.g., Baltimore & Ohio Railroad Co.* v. *Commissioner*, 29 B.T.A. 368 (and see the cases there cited, p. 372), affirmed, 78 F. 2d 460 (C.A. 4); *Borg & Beck Co.* v. *Commissioner*, 24 B.T.A. 995; Rev. Rul. 59-387, 1959-2 Cum. Bull. 56; I. T. 1836, II-2 Cum. Bull. 158 (1923). The rationale of the determinations is that the corporate advantage secured by the transaction, whether it be new capital, the retention of existing capital through a change in the corporate structure, or some other desired change in the corporate form, does not relate directly to the current income-producing business operation but, instead, primarily benefits the corporation for the indefinite future. See *Farmers Union Corp.* v. *Commissioner*, 300 F. 2d 197, 200 (C.A. 9), certiorari denied, 371 U.S. 861; *Motion Picture Capital Corp.* v. *Commissioner*, 80 F. 2d 872, 873 (C.A. 2); *First Nat'l Bank of St. Louis* v. *Commissioner*, 3 B.T.A. 807; 4 Mertens, *Law of Federal Income Taxation* (rev. ed.), Sec. 25.35.

These principles, as the Service has ruled (Rev. Rul. 60-254, 1960-2 Cum. Bull. 42), make clear that the cost of issuing a stock dividend is not deductible as an ordinary business expense.[3] The effect of a stock dividend on the issuing corporation, besides increasing the number of shares of stock outstanding, is to convert earned surplus into stated capital; as such, the amount of the dividend is no longer available for ordinary div-

[3] Contrary to the taxpayer's contention (Pet. [illegible]), there is no established administrative practice contrary to the position taken by the Commissioner in Rev. Rul. 60-254, and followed by the court of appeals in the instant case.

dend distributions. *Eisner* v. *Macomber*, 252 U.S. 189, 210–211; *United States* v. *Zions Sav. & Loan Assn.*, 313 F. 2d 331, 335 (C.A. 10). Thus, a stock dividend has no direct relationship to the carrying on of trade or business activities as required for deductibility by Section 1.162–1 of the Regulations. Instead, the stock dividend is in the nature of a betterment or improvement of the corporate structure, the costs of which are nondeductible as capital expenditures within the meaning of Section 263.

2. There is no conflict with other decisions. The only other cases involving the question presented here have been decided by the courts of appeals in favor of the Commissioner on the authority of the Eighth Circuit's decision in the instant case. *Arkansas Louisiana Gas Co.* v. *Commissioner* (C.A. 5), decided May 11, 1964 (64–1 U.S.T.C., par. 9483), affirming *per curiam* a decision of the Tax Court on March 15, 1963 (P-H Memo T.C., par. 63,077); *United Industrial Corp.* v. *Commissioner*, 331 F. 2d 605 (C.A. 6), affirming *per curiam* a decision of the Tax Court of November 28, 1962 (P-H Memo T.C., par. 62,280). The taxpayer's contention (Pet. 10) that the decision below was decided "in a manner conflicting" with decisions of this Court is without merit. Those cases, while involving the business expense deduction, raise entirely different issues.

3. Congress reviewed the area of corporate organizational expenses as recently as 1954 and allowed the amortization in Section 248 of certain expenses connected with the organization of corporations. It decided, however, not to grant tax relief for stock issu-

ance expenditures (H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 31, A64 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4056, 4201); S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 37, 224–225 (3 U.S.C. Cong. & Adm. News (1954), 4621, 4668, 4860–4861)) in the face of suggestions that a deduction or amortization be allowed for such expenditures, including outlays relating to stock dividends (House Hearings on General Revenue Revision, 83d Cong. (1953), pp. 167–168, 170, 174, 551, 599, 603–604, 1573; Senate Hearings on the Internal Revenue Code of 1954, 83d Cong., pp. 886, 888, 1050–1051, 1282, 2047–2441). Accordingly, as the court of appeals observed in the instant case (Pet. 20), "If a different conclusion is to be reached, that end is for the Congress and not for the federal courts."

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

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